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SUBJECT: RESPONSE TO USITC STUDY ON SUB-SAHARAN AFRICA: MOZAMBIQUE

REF: A. MAPUTO 837
¶B. STATE 85109

¶1. (SBU) SUMMARY: This cable responds to Ref B's request to provide an overview of the current physical infrastructure conditions of land transport (road and rail), maritime transport, and electricity in Mozambique to include capacity, state of repair, and state of technology; an overview of the current conditions of associated infrastructure service providers in logistics, port services, and electricity distribution, including ownership structure and market conditions; an overview of principal impediments, including any soft infrastructure conditions, such as customs procedures; an overview of efforts to improve conditions in land transport, maritime transport, and electricity infrastructure via policies, regulations, investment, and/or regional integration; and an analysis of the effect that the condition of Mozambique's infrastructure has on export competitiveness.
END SUMMARY.

¶2. (SBU) Mozambique's export-driven economic growth, averaging 8 percent since the end of the civil war in 1992, continues to be driven by its natural resource wealth, with Aluminum, Hydropower, and Natural Gas accounting for a majority of the value of total exports. Natural resource wealth has spawned a series of mega-projects aimed at expanding exports. Despite strong growth, Mozambique continues to be a least developed country of roughly 20 million inhabitants with per capita GDP for 2007 at $350, with development in the Maputo area far surpassing the rest of the country. Principal export commodities in 2007 included aluminum, cashews, prawns, cotton, sugar, citrus, timber, bulk electricity, and natural gas, with exports totaling $7.7 billion.

¶3. (SBU) U.S. companies are the leading source of Foreign Direct Investment (FDI), with investments of over $5 billion over the last five years. South Africa has invested more than $300 million since 2003, China has contributed $69 million, and India has contributed $14 million in the same period. According to the World Bank, FDI accounted for the equivalent of 42 percent of Mozambique's $8 billion GDP in 2007, and future FDI flows will continue.

¶4. (SBU) There are several mega projects currently driving FDI flows. Moatize in Tete Province is believed to be the largest unexplored coalfield in the world with estimated reserves of 2.5 billion tons. Temane gas fields near Maputo are being explored by South African company SASOL, and the Pande gas fields at Inhambane are already producing. Hydroelectrica de Cahora Bassa's (HCB) 2,000MW current capacity is expected to be augmented by a new 1,600MW dam also on the Zambezi River and an anticipated 1,600MW dam at Mpanda Kua. The heavy sands project at Moma in Nampula takes advantage of one of the largest titanium-bearing

heavy-mineral sands deposits in the world. Exploration for uranium, gold, diamonds, and potentially on and off-shore petroleum reserves is ongoing.

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CONDITION OF LAND AND MARITIME INFRASTRUCTURE
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¶5. (SBU) Mozambique's land infrastructure includes 3,524 miles of paved roads, and 14,988 miles of unpaved roads which become impassable during the rainy season. The road network is managed by an autonomous road agency, the National Administration of Roads (ANE), which is financed through a dedicated road fund. There are 1,942 miles of railway, with major lines connecting South Africa, Zimbabwe, and Malawi to Mozambique's three largest ports. Railway lines along the three main East-West corridors are managed by the parastatal Mozambique Ports and Railways (CFM), which in turn has delegated management to a consortium of private companies which are refurbishing the railways after years of neglect and sabotage during the civil war.

¶6. (SBU) Mozambique is geographically well placed to act as a regional shipping hub for southern and central Africa. The main ports include Maputo, with linkages to regional economic powerhouse South Africa. 700 miles north, another East-West corridor links the Port of Beira with Zimbabwe. 1500 miles north of the capital, the deep water Port of Nacala in Nampula Province provides potentially significant linkages to Malawi and Zambia. While most developed infrastructure corridors run
East-West, there is one main artery (EN1) running North-South

which connects Maputo to Nacala, with road quality deteriorating the further north traveled. Port expansion is a high priority for the Government of Mozambique (GRM) which has issued tenders for over $1 billion in upgrades, to include modernization of road and rail infrastructures linkages.

¶7. (SBU) The Port of Maputo, run by 60 percent stakeholder Dubai Ports World (DPW) is the largest facility by volume in Mozambique, with an expected volume of 8 million tons of cargo in 2008, up from 6 million tons in 2007, well below the pre-civil war high of 15 million tons. Shipping and logistics group Grindrod has made a substantial investment in the Maputo port, seeing it as a viable alternative to Durban with a potential capacity of 40 to 50 million tons per year in the next 10 years. Grindrod and DPW, both stakeholders in Portus Indico which in turn is the majority shareholder of the Maputo Port Development Company, are developing a Maputo Port Master Plan, which will be made public in early 2009. Though not finalized, the $300 million expansion plans for the Port of Maputo will include a ferrochrome terminal, car terminal, liquid bulk terminal, and coal terminal.

¶8. (SBU) Thanks to its geographical location and proximity to South Africa, the port as well as the Maputo Development Corridor leading through the border at Ressano Garcia to South Africa's industrial center in Gauteng province, provides an efficient transportation connection for export of South African goods. Shipping schedules to the Port of Maputo are not as frequent as Durban however, meaning that international cargo is often taken to Durban, and reloaded there to take advantage of more frequent sailing times. The rail line along the Maputo corridor has been rehabilitated, a natural gas line links Temane gas fields with consumers in South Africa, and a $600 million petroleum pipeline between the oil terminal at Matola and South Africa is expected to handle 350,000 barrels per day and should be operational by
¶2015. The GRM has also announced the approval of plans to construct an $8 billion oil refinery in the Corrdior, with anticipated production of 350,000 barrels per day by 2015.

¶9. (SBU) The Port of Beira and the Beira Corridor, acts as

the principal artery for goods to Zimbabwe. The corridor was severely damaged by the 17-year civil war and more recently by Cyclone Eline in 2000. Due to the economic collapse of Zimbabwe, current rail traffic only includes one freight train traveling in each direction per day. Roads are in good condition, allowing for truck transportation of containers and fuel between Beira and Zimbabwe. The Port of Beira suffers from lack of maintenance, particularly dredging, resulting in dangerous navigation for deep-drafted cargo ships. The reopening of coal mines at Moatize in Tete province means that the Indian firm Rites and Ircon plans to complete a spur line connecting the fields to the Beira Corridor and a new loading facility expected to handle 20 million tons of coal for export. Should Zimbabwe's economy recover, the Beira corridor would likely see heavy use related to aid and reconstruction.

¶10. (SBU) The Port of Nacala in Nampula province is a world-class natural deep water port with relatively poor road connections to Malawi and Zambia. In 2009, construction on a $5 billion 300,000 barrels per day oil refinery will begin, managed by the largest investor in the project, U.S.-based Ayr Logistics. Plans are also underway to develop a Nacala Special Economic Zone (SEZ) which will help the port attract manufacturing and develop infrastructure linkages based on anticipated offshore and onshore petroleum findings, with exploration currently ongoing. U.S.-based Anadarko Petroleum, which has already invested $500 million, is one of four partners carrying out seismic studies in the largely-offshore Rovuma Basin near the Mozambique-Tanzania border. If significant findings occur, drilling could begin by 2009, with production to follow between three to five years after that (by 2014). These four companies will likely use the smaller port at Pemba for reasons of efficiency in the exploratory and drilling stages of their work in Mozambique.

CONDITION OF ELECTRICITY INFRASTRUCTURE

¶11. (SBU) Parastatal Electricity of Mozambique (EDM) has monopoly control over the national grid. While Mozambique generates significant electricity for export to South Africa, Swaziland, and Zimbabwe from its largest dam, HCB (with 2,000MW and the potential to generate 14,000MW) on the

Zambezi river in the Province of Tete, transmission remains problematic due to a lack of transmission lines running to the country's industrial center in the South. Instead, transmission lines run west from HCB to the South African ApoL;XQ9Qbillion on a new
transmission line from Tete Province to Maputo. While feasibility studies have been completed, funding and a timeline for project completion have not yet been finalized. In May 2008, HCB announced plans to build new transmission lines to the Zambian border, allowing direct sale of electricity to its neighbor.

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CONDITION OF ASSOCIATED INFRASTRUCTURE SERVICE PROVIDERS
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¶12. (SBU) Kudumba, a port services company, represents one of the most significant associated infrastructure service provider challenges in Mozambique. In 2005, Kudumba won a 20 year concession contract with the GRM to provide border security via a high-energy x-ray system. In June 2006, the company began operations at the Port of Maputo, implementing a practice of 100 percent scanning (except for a few cleared freight-forwarding companies) of all goods that are imported, exported, or transited through Mozambique.

¶13. (SBU) This compulsory scanning has added significantly and unnecessarily to the cost of doing business in and

through Mozambique, with costs range from $20 to $100, depending on the size of the container scanned. On a recent visit to the Port of Maputo, PolOff saw South African 5-ton solid blocks of granite destined for export to the EU that were subject to mandatory scanning. The business community continues to complain that the Kudumba scanner is more of a revenue generator than a border security program, pointing out that the company is 35 percent owned by SPI, a holding company for the ruling FRELIMO party. While currently operating in Maputo andPI]A2W-QQQ----------------------

¶14. (SBU) Principal impediments to export competitiveness include a lack of usable infrastructure; weak human capital due to poor levels of education; an unwelcoming business environment; rent-seeking behavior by the business-political elite; corruption at all levels of government; and antiquated labor and land ownership laws. Mozambique's history of colonization followed by a turbulent independence movement and years of Marxist rule during a violent civil war in which infrastructure was a target of guerrilla groups means that Mozambique started in 1992 from a very lowbase, not only in terms of physical infrastructure, but also soft infrastructure. For example, poor education means illiteracy rates reach 60 percent, there are roughly 600 qualified doctors for a country of 20 million, and the health system cannot effectively address high prevalence rates for HIV and other treatable diseases, presenting a major impediment to work force continuity.

¶15. (SBU) Mozambique's labor laws, a vestige of the country's Marxist-Leninist past, also present problems for foreign investors. Protection of worker rights is central to the law, with inflexible hiring and firing rules, further compounded by a lack of technically qualified third-country nationals. As a result of restrictive labor laws and weak a weak education system, foreign investors find if very difficult to either find qualified Mozambicans, or legally hire qualified third-country nationals. Many provisions in the labor law make for an uninviting environment for investment. As a result, under current labor laws, foreign investment is best suited for low skill extractive and agricultural industries.

¶16. (SBU) The concept of private land ownership does not exist in Mozambique. In December 2006, the Government of Mozambique (GRM) modified property laws allowing for renewable 100 year leases, minimizing restrictions on transferability of land tenure titles. In rural areas, the government grants 50-year concessions for land use. Lack of land ownership causes significant problems for credit markets, which often require high percentage collateralization of loans. These land ownership

prohibitions are a challenge to potential investment in the agricultural sector, with an estimated 89 million acres of arable land, of which only 10 percent is being used. Mozambique's 60 major rivers mean that over 8 million acres of land is available as potentially irrigated land. The Zambezi valley is expected to see significant Chinese investment in irrigated farm land for rice production.

EFFORTS TO IMPROVE INFRASTRUCTURE

¶17. (SBU) The World Bank's International Development Association (IDA) has financed infrastructure projects in the three main East-West transport corridors, as well as secondary roads, rehabilitating over 4,000 miles of road infrastructure at a cost of $965 million between 1992 and 2003, resulting in a 50 percent reduction in road travel times on average.

¶18. (SBU) While many donors have focused on infrastructure enhancement projects, the Millennium Challenge Corporation

(MCC) has signed a compact to provide $507 million over five years, focused on water and sanitation, road, land tenure, and farmer income support projects in less-developed northern Mozambique. Water and Sanitation projects of $204 million will increase access to safe drinking water and reduce the spread of water-borne diseases in Zambezia, Nampula, and Cabo Delgado provinces, with a projected impact of assisting nearly 2 million Mozambicans by 2015. The road transportation project, valued at $176 million, will expand connectivity across the northern region, in part rehabilitating 491 kilometers of EN1, effecting 2.3 million Mozambicans. The $39.1 million land tenure project will further rationalize land tenure policy and provide better land-related information systems and services, benefiting 1.9 million Mozambicans by 2015.

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ANALYSIS: INFRASTRUCTURE'S EFFECT ON EXPORT COMPETITIVENESS
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¶19. (SBU) Physical infrastructure and soft infrastructure deficiencies both significantly hamper export-driven economic growth in this geographically well-situated, resource-rich country. Significant investments are in the pipeline to develop Mozambique's land and maritime transportation network as well as its electricity infrastructure. The most challenging aspect of infrastructure development will be improvements to soft infrastructure issues that have more to do with political will than regulatory changes.

¶20. (SBU) Post expects that regulatory changes that result in improvement of the business climate will continue at a slow pace due to the current regime's historically socialist perspectives (particularly on land and labor issues), though the Guebuza administration's significant business interests mean that it is in their interest to continue to improve the country's export competitiveness. FDI flows will continue to increase, particularly to mega-projects, not necessarily because of the quality of infrastructure or ease of doing business, but because of Mozambique's natural resource wealth, including its large tracts of arable land. Mozambique is still some years away from moving up the value chain towards intensive manufacturing due to a lack of infrastructure and a dearth of skilled workers, though tariff liberalization in the SADC region could mean that South African firms may find it competitive to move their manufacturing operations to Mozambique, where labor costs are significantly lower.
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